Finally, the Commission should consider the fact that the decrease in benchmarks will affect the ability of private parties to negotiate favorable conditions with ILECs. Just as the Commission uses benchmarks as regulatory tools to keep firms with market power in check, private parties use benchmarks to compel ILECs to match each other's capabilities. As noted above, when mergers occur, incentives become aligned, and benchmarks are decreased. As a result, competitors have less opportunity to exploit the differences between the ILECs, thereby affecting the efficiency of the market and the ability of competitive firms to offer competitive services in a proficient manner.

V. The Merger Would Also Have Anticompetitive Effects in the Video Distribution Markets And Raises Substantial Questions of Lawfulness Under Section 652.

Almost as an afterthought to the application, SBC and Ameritech briefly acknowledge, without any real discussion, the presence of Ameritech in the local video distribution markets in Ohio, Illinois, and Michigan. The applicants assert summarily that "[the] merger will not adversely affect competition in the market for multichannel video programming distribution."[60] The filing further notes that "the main competitive alternatives to cable are wireless ones, *with the exception* of SNET's and Ameritech's overbuilds. . . ."[61] The applicants do not address

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60 See Description at 101. The filing notes that 87% of customers subscribing to multi-channel video systems are served by traditional cable companies. See id. at 100-101.

61 Id. at 101 (emphasis added). Compare Ameritech's statements to the Commission, in CS Dkt. No. 98-102, insisting that DBS service "fails to constrain cable price increases." Comments of Ameritech at 15, Notice Of Inquiry Annual

what plans the merged entity may have to expand or even continue this business. The applicants do not address the fact that SBC shut down PacTel's competitive video distribution business once it was allowed to acquire these assets. The applicants do not address the fact that SBC had in fact represented to the FCC that one benefit of its acquisition of Pacific Telesis would be to foster video competition.[62] And the applicants do not address how the proposed transaction can be squared with the plain language of Section 652 of the Communications Act.

Ameritech's cable service in its region is substantial. Ameritech describes its video operations as "the largest cable

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Assessment of the Status of Competition in Markets for the Delivery of Video programming, filed July 31, 1998 ("Ameritech Video Competition Report Comments").

62 See Joint Opposition of SBC and PacTel to Petitions to Deny at 37 (filed in FCC Report No. LB-96-32 Aug. 9, 1996)("SBC and Telesis were taking steps to pursue entry into the provision of video services through different means and only in different geographic areas, and consumers will benefit from the combination of those efforts. Both companies are new entrants into a field with large, entrenched firms. The proposed merger will enable the stronger merged company to benefit from each of SBC's and Telesis' accumulated expertise and will facilitate innovative and timely deployment.")(citations omitted; emphasis in original); Application of SBC and PacTel, Public Interest Statement at 12 (filed June 7, 1996) ("A key goal of the 1996 Act is to expand competition in video programming and distribution. It established multiple options for entry by telephone companies. Before the new law, SBC and Telesis each took steps to enter video services in different areas -- including SBC's cable operations in the Washington, D.C. Metropolitan Area and Richardson, Texas; Telesis' MMDS and other video authorizations in California and elsewhere; and both companies' interests in video programming ventures. The proposed merger will enable them to benefit from each other's accumulated expertise and facilitate innovative and timely deployment of video services and facilities").

overbuilder in the country."[63] According to Ameritech, it holds "franchises in 78 communities having a total population of more than 3 million people living in over one million homes." See Ameritech Video Competition Report Comments at 11. It operates cable systems in 61 communities; doubling in one year the number of its served communities. It has 150,000 cable subscribers; and reports that it has captured market share of "[o]ne out of every three cable subscribers where Ameritech is marketing...." Ameritech Video Competition Report Comments at 11.

Ameritech's cable overbuild activity has apparently been competitively significant. In its July 31, 1998 filing, Ameritech catalogued at length the competitive responses from cable operators, claiming that its innovative service has "spurred incumbent cable operators into action, causing them to modify their service and respond with their own version of improved, higher quality service offerings at more affordable prices." Ameritech Video Competition Report Comments at 11 and Attachments 1 and 2 thereto. Further, Ameritech has at the federal level been active in seeking ways to facilitate competitive video markets, including especially its successful efforts at the Commission to revise its program access complaint procedures.[64]

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63 Comments of Ameritech New Media, Inc. in MM Dkt. No. 92-264 and CS Dkt. No. 98-82, at p.1 n.1. (filed Aug. 14, 1998).

64 See Petition for Rulemaking of Ameritech New Media, Inc., Report and Order, CS Docket No. 97-248, FCC 98-189 (rel. Aug. 10, 1998).

Because Ameritech has specifically sought elsewhere to demonstrate the competitive value of its cable systems, it is imperative that the Application provide substantially more information to explain and demonstrate the effects of the merger on these video distribution markets. Especially given SBC's apparent decision to withdraw its own and PacTel's entries into these markets, it is woefully insufficient to merely state that SBC will step into the shoes of Ameritech here. Moreover, as described below, it appears that Section 652 precisely precludes SBC from so doing.

Section 652(a) of the Act prohibits local exchange carriers from acquiring more than a 10% financial interest in cable operators that provide cable service within the LEC's telephone service area.[65] Like the more restrictive cable-telephone company cross-ownership prohibition that preceded it, Congress adopted Section 652 to ensure that incumbent LECs do not utilize their monopoly power to stifle competition in the video programming market.[66] Unlike the cross-ownership statute that preceded it, however, Section 652 contains express provisions governing ILEC attempts to acquire not only the first cable

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65 47 U.S.C. § 572(a).

66 <u>See</u> H.R. Rep. No. 103-560 (1994) ("Concern over the telephone companies' potential to capitalize on their position as a monopoly service provider, their ability to cross subsidize illegally to finance any new cable plant, and their potential to stifle competition in the growing video and information services industry has been the thrust of the argument against telephone company entry into new lines of business.")

system in the market but any overbuild systems as well. The Commission incorporated Section 652 into its rules regarding the ownership of cable systems shortly after the passage of the Telecommunications Act of 1996.[67]

Section 652(e) defines "telephone service area" as:

> the area within which [the] carrier provided telephone exchange service as of January 1, 1993, but if any common carrier after such date transfers its telephone exchange service facilities to another common carrier, the area to which such facilities provide telephone exchange service shall be treated as part of the telephone service area of the acquiring common carrier and not of the selling common carrier.[68]

Because Ameritech is effectively transferring its facilities to SBC under the proposed merger, Section 652(e) indicates that SBC's telephone service area must include Ameritech's service area for the purposes of Section 652.

SBC is of course acquiring control of Ameritech's cable service operation as well as its telephone facilities. Because Ameritech's cable operations provide service within SBC's telephone service area as defined by Section 652(e), Section 652(a) prohibits the merger unless the acquisition falls under one of Section 652(d)'s enumerated exceptions. Information available suggests that the merger is not covered by any of the exceptions,[69] including Section 652(d)(3).

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67 See Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, CS Dkt. No. 96-85, *Order and Notice of Proposed Rulemaking*, 11 FCC Rcd 5937, 5953-56 (1996).

68 47 U.S.C. § 572(e).

69 Sections 652(d)(1) and (d)(2) apply to rural systems and joint use agreements, respectively. Because Ameritech's

Section 652(d)(3) applies to acquisitions in "competitive markets" that is, markets where more than one cable system is present.[70] The subsection provides certain specified exceptions to the general anti-buyout prohibition. For an acquisition to fall under its umbrella, Section 652(d)(3) requires that (A) the subject cable system operates in a non-top 25 television market, the market has more than one cable operator, and the subject cable system is not the system with the most subscribers in the market; (B) the subject cable system and the system with the most subscribers held franchises, with identical boundaries, from the largest municipality in the market as of May 1, 1995; (C) the subject system is not owned by any of the 50 cable systems with the most subscribers as such systems existed on May 1, 1995; and (D) the system with the most subscribers is owned by one of the 10 largest cables systems operators as such operators existed on May 1, 1995.[71] All of these requirements must be met; if they

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cable operations are not located in rural areas, and because the proposed merger goes beyond a joint-use agreement, those sections do not seem to apply. See 47 U.S.C. § 572(d)(3)(A), (4)(C). Section 652(d)(4) does not apply because it requires the cable system to be acquired to operate in a non-top 100 market. See 47 U.S.C. § 572(4)(C). Ameritech's cable service operations in Chicago, Detroit, Cleveland, and Columbus are all in top 100 markets. See 1 Broadcasting & Cable Yearbook 1998 B-234 (Reed Elsevier 1998). Section 652(d)(5) does not apply to the proposed merger because it requires the LEC's annual operating revenues to be less than $100,000,000. 47 U.S.C. § 572(d)(5).

70 See 47 U.S.C. § 572(d)(3).

71 See id.

are not all met, then the general rule against acquisition applies.

At a minimum, subsection (A) is not satisfied as it pertains to three substantial markets in Ameritech's cable service area. Chicago, Detroit, and Cleveland are all top 25 television markets.[72] Ameritech's cable systems in those markets therefore fall outside of the scope of Section 652(d)(3)'s exception. The proposed merger may fail to meet other requirements of Section 652(d)(3), but further information not readily available would be required to make such a determination. SBC and Ameritech must also demonstrate compliance for those markets not already excluded from the exception by the top 25 market requirement.

Section 652 of the Act prohibits the type of telco-cable buyout that would occur if the proposed SBC-Ameritech merger is approved. On its face, the merger does not appear to fall within any of the exceptions enumerated in Section 652. If information exists that demonstrates otherwise, the burden to produce that information must fall on SBC and Ameritech.[73] Absent such a showing (which does not appear factually possible), the transaction is unlawful under Section 652.

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72 See 1 Broadcasting & Cable Yearbook 1998 B-234 (Reed Elsevier 1998).

73 See 47 U.S.C. § 309(e) (burdens of proceeding and proof rest upon applicant). See also *Bell Atlantic-NYNEX,* at ¶ 29 and n.55 (further citations omitted).

VI. The Claim That the Merger Will Prompt the Merged Parties to Enter 30 Out-of-Region Markets Is Not Credible or Enforceable, and It Cannot In Any Event Compensate for the Anticompetitive Effects of the Merger.

The Commission should approach the promise of entry into 30 markets out-of-region with great skepticism. The Application does not on its own terms demonstrate its most fundamental assertion: The National-local strategy is not shown to be merger-specific. As fully analyzed by both Steven Signoff, Vice President, Strategic Business Development, October 12, 1998, (Attachment G), and Drs. Besen, Srinagesh and Woodbury, the "follow the customer" premise of the strategy defies commercial realities, common sense and does not, in any event, have any substantiated tie with the merger. Contrary to the claims made in the Application, moreover, Drs. Besen, Srinagesh and Woodbury conclude that the merger is likely to result in higher not lower local prices in the fifty markets. The strategy also necessarily assumes Section 271 authority and thus is highly contingent and unlikely to be implemented within its stated time frame. Finally, even if accepted at face value, the strategy cannot as a matter of law or policy compensate for the in-region anticompetitive effects of the transaction.

A. The strategy has not been shown to be merger-specific, nor likely to result in lower prices.

Drs. Besen, Srinagesh and Woodbury fully analyze the claimed benefits of the National-local strategy in the attached paper, "Economic Analysis of the SBC/Ameritech Merger." As demonstrated there, even if one assumes the credibility of the plan, the merger does not appear necessary to its implementation. In a number of critical respects, the assumptions that underlie the 30-market strategy are inconsistent with other assumptions and assertions claimed in the Application. For example, the applicants' insistence they will either enter *all* 30 markets (if allowed to merge) or not enter *any* market (if not allowed to merge) is not credible. Affidavit of James S. Kahan at ¶ 85 ("Kahan"). This all-or-nothing position is inconsistent with the Application's assertion of a "follow the customer" strategy, described to be essential to the parties' ultimate economic survival. If it is so important, must not out-of-region entry be pursued regardless of the merger? Will it not be pursued incrementally (i.e., in a smaller number of markets and thereafter rolled out to others) if it is not feasible to perfect all at once? And if the number of out-of-region markets targeted for entry is decreased, wouldn't the parties be all the more capable of pursuing the strategy independently, without the merger?

In addition, the assertion that the applicants must serve all telecommunications needs of its customers is contrary to competitive realities. Many of the largest business users (the initial targets of the 'National-local strategy') purchase their long distance services from more than one carrier, for a variety of reasons explained in the affidavit of Steven Signoff. For these and other problems they identify, Drs. Besen, Srinagesh and Woodbury conclude that each party to the merger could pursue a similar strategy independently and give consumers more competitive choices by doing so. SBC itself insists that in-region states will have the benefit of competition because of retaliatory entry by other RBOCs once SBC and Ameritech begin to deploy their 30-market strategy (Kahan at ¶ 88). If so, it will far better serve consumers to block the merger, leaving Ameritech to continue its competitive expansion into SBC's territory, and thereby prompt SBC to 'retaliate' by entering Ameritech states.

There remains the further problem of how the promise to enter 30 markets could ever be enforced by the Commission. What if, as has certainly already happened with these companies, business strategies are altered after the merger?[74] It is implausible that the Commission could actually hold SBC and Ameritech to their promises: how could the government successfully command private firms to enter markets and compete? In any event, as Drs. Besen, Srinagesh and Woodbury discuss, the "promise" is more illusory than real.

Perhaps the most disconcerting aspect of the 30-market strategy claim is its implicit vision of the scale needed to compete. To accept SBC's and Ameritech's views, the Commission would have to conclude that there is room for no more than two extraordinarily large local telephone companies in the U.S. telecommunications marketplace. And indeed, if there are only two, the far stronger incentive for these two will be market division -- not the sort of reciprocal invasion SBC and Ameritech

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74 As discussed earlier, the same promises were made to regulators by SBC in the context of its acquisition of Pacific Telesis and its video businesses. These businesses were shut down soon after the transaction was consummated.

have described. For these reasons alone, the strategy is not credible.

B. By its terms, the strategy requires Section 271 authority throughout the SBC and Ameritech states and thus will not be implemented within the asserted time frame.

Although vague about the precise timing, the Application implicitly suggests that this strategy will begin implementation next year. It anticipates offering service to residential users "within one year of the closing...and plans to offer service to a majority of the households in the 30 out-of-region markets within four years of closing." Kahan at ¶ 63. Because the Application describes the need to first "follow" the largest customers who then become "anchor tenants" and a base for smaller business and residential users, the internal logic of the schedule suggests near-immediate commencement of business service offerings. It is also worth emphasis here that the Application describes a 'shot-gun' approach, in which entry into of these local markets is planned virtually simultaneously.

What the applicants omit here is the critical fact that the plan requires Section 271 authority in order to succeed on its own terms, and thus necessarily assumes grants within this time period. Given the remoteness of Section 271 compliance for these companies throughout their states, the plan necessarily fails on this ground as well.

In a preliminary hearing before the Public Utilities Commission of Ohio on July 22, 1998, representatives of SBC and Ameritech described their proposal to the state. In response to questioning, Jim Ellis, General Counsel of SBC, explained that 271 authority is in fact a *sine qua non* of the strategy:

> COMMISSIONER MASON: If I understand your presentation,... one thing sounds certain, that SBC/Ameritech intend to achieve the 271 test in order, if I understand your -- your 50-city strategy correctly. So I guess what I want to know, then, is this sounds like you're committed to a timely, and I guess I'm questioning what the time frame would be, on achieving the 271 test.
>
> MR. ELLIS: Yes. This -- This strategy only makes sense if you are able to link up those cities. The middle piece of -- of the three-part strategy is to become a -- a long-distance competitor. And to do that, you have to -- while we have the authority today to operate long distance out of our region, it -- it is not an effective tool. You cannot go to a customer in -- in Chicago and -- and offer them a complete package of services in Seattle where you can provide long distance and not in Chicago or in Dallas. *And so we have, from the beginning, viewed this transaction as -- as absolutely requiring that we satisfy the 271 requirements and obtain long distance relief in every one of our states.*

Presentation by Representatives of SBC and Ameritech Concerning Their Proposed Merger at 22-24, SBC-Ameritech Merger Proceedings before Ohio PUC, (July 22, 1998) (transcript of videotapes) ("Ohio Transcript") (emphasis added).

The problem is, of course, that the two RBOCs are nowhere near ready for 271 authority. A review of the status of 271 proceedings in their states is revealing on this point. None of these states has found that the companies are in compliance with the full set of 271 requirements. In fact, the state commissions in Texas, Arkansas and Kansas have all expressly advised SBC that it is not in compliance at this time, and will have substantial work to complete before they will recommend 271 authority to the

FCC.[75] California and Oklahoma are in the middle of proceedings to discern compliance, and the remaining SBC states, Nevada and Missouri, have not even begun proceedings at this time.

In the case of Ameritech, it has made crystal clear its willful refusal to bring itself into compliance with its 271 obligations, on the grounds that it "disagrees" with the Commission's interpretations in this area. At the July hearing in Ohio, Ameritech-Ohio's general Counsel Kelly Walsh suggested to the Ohio Commission that it would not try to pursue 271 authority from the FCC until the Court of Appeals has resolved the shared transport decision, and the Supreme Court has resolved the UNE combination issue. See Ohio Transcript at 24. Since

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75 See Pacific Bell and Pacific Bell Communications Notice of Intent to File Section 271 Application for InterLATA Authority in California, U 1001 C, *California PUC Telecommunications Division Final Staff Report* (Oct. 5, 1998); Application of Southwestern Bell Telephone Company Seeking Verification That It Has Fully Complied With And Satisfied The Requirements of SEC. 271(C) Of The Telecommunications Act of 1996, Dkt. No. 98-048-U, *Consultation Report of the Arkansas Public Service Commission to the Federal Communications Commission Pursuant to 47 U.S.C. § 271(d)(2)(B)* (1998)(finding numerous issues of non-compliance, including inter alia that SWBT's provisioning if UNEs to be so untimely as to preclude CLEC compliance with state quality standards, malfunctions in SWBT's provisioning of 911 service, and numerous other failings); Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Market, PUC Project No. 16251 (Tex. PUC 1998)(stating that PUC cannot find that SWBT is compliant, and ordering further collaborative process to address dozens of issues raised in the order). The Kansas Corporation Commission has similarly refused to endorse SBC's conduct at this time, relying upon a staff recommendation which identified numerous deficiencies in SWBT's 271 filing. See "Kansas Declines to Back SWBT's InterLATA Plans," Telecommunications Reports at 11 (Aug. 31, 1998).

that time, of course, the 8th Circuit has upheld the FCC's decision requiring the provision of shared transport as a UNE, but Ameritech has announced to the FCC that it now finds the court's decision disagreeable, that it will petition for rehearing, and that even if the court's decision is not modified, Ameritech's view is that it will still not make the required offering. See Ex Parte Filing by Lynn Starr, Executive Director, Federal Relations, to Magalie Roman Salas, Secretary, FCC (filed Sept. 8, 1998) "Ameritech's View of the Roadmap" at 8-12. This filing makes explicit Ameritech's unwillingness to bring itself into Section 271 compliance in numerous ways, including OSS (fully electronic interfaces, "the Commission has been far too negative regarding business decisions to use manual processing. . . "), performance measures ("[p]arity comparisons with retail equivalents. . . " sufficient for some purposes), and UNE combinations (collocation is "the only authorized method. . . "). Ameritech by its own words will not comply with Section 271's provisions until it has been told to do so by Supreme Court decree -- if then. It has apparently discontinued efforts to obtain favorable state recommendations in the interim.

Given the efforts of these carriers to minimize and undermine the underlying policy objectives of the 1996 Act, neither SBC nor Ameritech can claim to be within reach of 271 grant in any state, never mind in each and every one of their states. This makes the 30-market strategy, contingent as it is on 271 authority *nationwide*, much more uncertain and remote than it might have already appeared even from the outset.

C. Even if accepted at face value, the strategy to 'Jump-start' competition out-of-region cannot as a matter of law or policy override the anticompetitive effects of the merger in-region.

Even if the Commission were to accept everything the parties have promised as true, the National-local strategy would still not overcome the plainly anticompetitive effects of the merger in other markets, i.e., interLATA services, in-region local telecommunications markets and new services. The applicants are thus simply wrong in asserting that any horizontal adverse effects on competition in the in-region markets somehow can "be overwhelmed by the tremendous pro-competitive and other benefits of the merger" out-of region. Application at 10. Under a traditional competitive analysis, as required by the Clayton Act, alleged pro-competitive benefits in one set of markets cannot be used to justify a merger that would have predictable anticompetitive effects in other markets. The public interest may be a more flexible standard, but it nevertheless will not tolerate consumer welfare being diminished in one market to supposedly improve it in another.

The Clayton Act prohibits mergers that lessen competition "in any line of commerce or in any activity affecting commerce in any section of the country."[76] The courts have consistently interpreted this language as meaning that an acquisition is unlawful if it has anticompetitive effects in any line of commerce in any section of the country. For example, the merging

[76] 15 U.S.C. § 18.

parties in United States v. Bethlehem Steel[77] admitted that their merger would reduce competition in certain areas of the country.[78] In defense of the merger, the parties insisted that the total steel production capacity of the resulting company would expand and stimulate competition both in current and new markets.[79] Further, they argued that the merger would allow Bethlehem Steel to challenge the dominant position of the U.S. Steel Corporation. The court rejected these arguments:

> The simple test under § 7 is whether or not the merger may substantially lessen competition 'in any line of commerce... in any section of the country.' A merger may have a different impact in different markets-- but if the proscribed effect is visited on one or more relevant markets then it matters not what the claimed benefits may be elsewhere.[80]

In United States v. Philadelphia Bank,[81] the Supreme Court specifically rejected the argument that anticompetitive effects in one market can be justified by procompetitive benefits in another.[82] The banks contended that the proposed merger would increase the resulting bank's lending limit and thereby enable it to compete with large out-of-state banks, particularly New York Banks, for very large loans. The court held that this defense would lead to an absurd conclusion:

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77 168 F.Supp. 576 (S.D.N.Y. 1958).

78 Note, they argued that this decrease would not "substantially" reduce competition in these areas.

79 Bethlehem Steel, 168 F.Supp. at 581.

80 Id. at 618.

81 374 U.S. 321 (1963).

82 Id. at 370.

> If anticompetitive effects in one market could be justified by procompetitive consequences in another, the logical upshot would be that every firm in an industry could, without violating § 7, embark on a series of mergers that would make it in the end as large as the industry leader. For if all the commercial banks in the Philadelphia area merged into one, it would [still] be smaller than the largest bank in New York City. This is not a case, plainly, where two small firms in a market propose to merge in order to be able to compete more successfully with the leading firms in that market.[83]

The courts and antitrust policymakers reject the multi-market balancing approach because it would force them to favor one group of consumers (those in the new market) over another group of consumers (those in the target market). In both Bethlehem Steel and Philadelphia Bank the merger proponents argued that, viewed as a whole, their respective mergers would result in net welfare gains to society. The Bethlehem Steel court specifically rejected this form of selective favoritism.

> Any alleged benefit to the steel consumer in the Chicago district because of reduced freight charges and an increased supply, cannot, under the law, be bought at the expense of other consumers of numerous other steel products where the effects of the merger violate the Act.[84]

Areeda and Turner conclude that the defense of an otherwise anticompetitive merger with a multi-market balancing approach has been rejected for a broad policy reason:

> To balance losses in one market against potential gains in another would necessarily favor one group of consumers over another.[85]

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83 Id. at 370-371.

84 Bethlehem Steel, 168 F.Supp. at 618.

85 Areeda and Hovenkamp, Antitrust Law, ¶ 942 (1996).

SBC and Ameritech argue that the purported actual benefits to competition resulting from its merger should outweigh any possible anticompetitive harms caused by eliminating a *potential* competitor in the target market.[86] SBC and Ameritech cite Hovenkamp for support.[87] Neither Hovenkamp's treatise, nor the case law discussed there, supports the argument that increases in *actual* competition resulting from SBC/Ameritech's entry in 30 new markets should outweigh the anticompetitive effects due to a loss of *potential* competition in other markets. In his treatise, Hovenkamp emphasizes that actual competitive benefits should outweigh losses in potential competition only when both effects would be felt in the same market.[88] The distinction between mergers where both the negative and positive effects occur in the same market, and those where they occur in different markets is

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86 Application at 84.

87 Description, at 85, citing H. Hovenkamp, Federal Antitrust Policy § 13.4a (1994) ("given the elusive nature of potential competition, it must be disregarded when weighed against improvements in actual competition that are likely to flow from a merger") ("Hovenkamp").

88 Hovenkamp at 512. The only case discussed by Hovenkamp to support the statement is United States v. Marine Bancorporation, 418 U.S. 602 (1974). In Marine Bancorporation, the Supreme Court permitted a bank merger despite the fact that the merger would eliminate a *potential* competitor in the target market. In approving the merger, the Court relied heavily on the trial court's finding that the resulting combination would increase actual competition in the same target market. 418 U.S. at 616. Thus, the actual competitive benefits identified in Marine Bancorporation occurred in the *same* market that experienced the loss in potential competition. Hovenkamp himself emphasizes the word "same" in his treatise. He compares the Marine Bancorporation case with the Philadelphia Bank case, and distinguishes the two cases on this fact alone.

crucial. When the competitive benefits occur in the same market where a potential competitor is eliminated, the negative and positive effects can be weighed against one another to determine the net effect in the relevant market. Where the effects are experienced in distinct markets, policymakers are forced to choose the importance of competition in one market over another. Here, SBC and Ameritech would force the Commission to choose (ostensibly) competitive entry outside of the merged entity's region at the expense of foreclosing competitive entry in-region. Plainly, consumers in Cleveland are entitled to the benefits of local telephone competition as much as consumers in Atlanta.

While the Communications Act grants the FCC more flexible decisionmaking authority than the FCC would have when it is constrained by the language of the Clayton Act, the public interest test requires the same conclusion here. It is hornbook law that the public interest standard is a broad, flexible standard, encompassing the 'broad aims of the Communications Act'.[89] This breadth of discretion does not allow the FCC to ignore actual anticompetitive effects, however.

The public interest standard of course requires consideration of the effect of the transfer on competition,[90]

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89 *Bell Atlantic-NYNEX,* at ¶ 2.

90 Craig O. McCaw and AT&T For Consent to the Transfer of Control of McCaw Cellular Communications, Inc. and its Subsidiaries, FCC 94-238, *Memorandum Opinion and Order*, 9 FCC Rcd 5836 at ¶ 9 (1994), recon. denied 10 FCC Rcd 11786 (1995) aff'd SBC Communications Inc. v. FCC, 5 F.3d 1484 (D.C. Cir. 1995) ("AT&T/McCaw").

although the impact on competition is one of many issues the FCC may consider when deciding whether a given merger would be in the public interest.[91]

> Our examination of a proposed merger under the public interest standard includes consideration of the competition policies underlying the Sherman and Clayton Acts...but the public interest standard necessarily subsumes and extends beyond the traditional parameters of review under the antitrust laws.[92]

FCC concerns other than competition include, but are not limited to: deregulation policy, universal service, and technological innovation. [93]

The traditional articulation of the public interest standard and the relevance of competition analysis has changed over time. Legal scholars recognize that competition may be only one consideration among many in the FCC's calculus, but conclude that it has become an increasingly important consideration.[94] Indeed, in the context of its Title II duties, the statutory context that defines the parameters of the public interest standard has changed dramatically from the original Act. Congress at one time presumed that telecommunications services subject to the Act would have to be provided on a monopoly basis, and generally accepted that competition would be "wasteful" or "ruinous." Subsequently, the Commission struggled to reinterpret the public

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91 United States v. FCC, 652 F.2d 72, 96 (D.C. Cir. 1980).

92 *Bell Atlantic-NYNEX*, at ¶ 2.

93 Id.

94 Friedrich, Jason E., 6 Commlaw Conspectus 261, 266, 1998.

interest as it became aware that at least some of these assumptions were inaccurate, or at least were worth testing.[95] The Act, as amended by the 1996 Act, has now brought this learning into the statute: Congress has declared that competition should be presumed possible - indeed it compels that substantial steps be undertaken to bring about competition. Thus, a traditional public interest calculus, leaving competition as just one factor among many to be considered, does not capture the current law as prescribed by Congress.[96]

In any event, research discloses no case in which the FCC opted to promote competition in one market at the expense of diminishing competition in another.[97] Whether under the new public interest standard as derived from the 1996 Act or a more

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95 See Hawaiian Tel. Co. v. FCC, 498 F.2d 771, 775-76 (D.C. Cir. 1974); FCC v. RCA, 346 U.S. 86, 93 (1953); All America Cables & Radio v. FCC, 736 F.2d 752, 755 (DC Cir. 1984); Computer and Communications Indus. Ass'n, 693 F.2d 198, 217 (D.C. Cir.), cert. denied 461 U.S. 938 (1983); Telocator Network of America v. FCC, 691 F.2d 525, 544 (D.C. Cir. 1982).

96 The competition element within the public interest standard is harder to satisfy that the Clayton Act. "In order to find that a merger is in the public interest, we must, for example, be convinced that *it will enhance competition.*" *Bell Atlantic-NYNEX,* at ¶ 2.

97 See, e.g., AT&T/McCaw, 9 FCC Rcd 5836 (1994), recon. denied 10 FCC Rcd 11786 (1995) aff'd SBC Communications Inc. v. FCC, 5 F.3d 1484 (D.C. Cir. 1995) (FCC found that the merger would not impose any anticompetitive effects but nonetheless required the merging parties to agree to certain equal access provisions); United States v FCC, 652 F.2d 72, 106 (upholding FCC grant to SBS to operate three domestic satellites, finding that FCC reasonably concluded that entry by SBS into satellite communications service would not be anticompetitive).

traditional articulation, the FCC has never forced itself to select one set of consumers over another. SBC's and Ameritech's invitation to do so should be summarily denied.

In *Bell Atlantic-NYNEX*, the FCC concluded that the merger, on its face, would have anticompetitive effects:

> taking the merger on its terms alone and without any other considerations, we believe that applicants have failed to carry their burden of showing, under the public interest standard, that entry would be sufficiently easy to mitigate the potential harms to competition from merging the leading and no less than fifth most significant participant in the market for providing telecommunications services to residential and small business customers.[98]

Despite these anticompetitive consequences, the FCC permitted the merger provided the parties adhered to certain conditions:

> We believe these conditions create pro-competitive benefits that at least in part mitigate the potentially negative impacts of the proposed merger on competition in LATA 132 and the New York metropolitan area, and that when extended through the Bell Atlantic and NYNEX regions, outweigh any other adverse effects in those areas. These conditions will make it more likely that other market participants can enter, expand or become more significant market participants that are capable of mitigating in the relevant market, the competitive harms that we otherwise foresee as likely resulting form the elimination of Bell Atlantic as a likely independent market participant.[99]

While the FCC did give consideration to the fact that the procompetitive effects would extend into geographic markets beyond those in which the anticompetitive effects would occur, it also found the procompetitive promises made and conditions imposed offset the anticompetitive harms within the same

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98 *Bell Atlantic-NYNEX,* at ¶ 12.

99 Id. ¶ 14.

geographical markets that suffered the predicted competitive harms. SBC and Ameritech, on the other hand, propose to offset the anticompetitive harms in one market with procompetitive gains in another. As demonstrated, neither the Clayton Act nor the Communications Act permits such a rationale.

VII. Other Claimed Efficiencies Are not Supported.

The other claimed efficiencies of the merger are at best unsupported and, in practice, unlikely to be realized. The Application identifies five additional efficiencies purported to be achieved by the proposed merger: (1) the combination of SBC and Ameritech resources will enhance investment opportunities and speed the introduction of new services and technologies;[100] (2) the proposed merger will facilitate diffusion of best practices between the two companies, lowering costs and facilitating the deployment of new services;[101] (3) the proposed merger will allow the merged company to exploit economies of scale and scope and enable purchasing economies;[102] (4) the proposed merger will facilitate the efficient and timely development of necessary standards;[103] and, (5) the proposed merger will generate approximately $778 million in revenue synergies.[104] However, the Application offers no empirical evidence and thus no confirmation

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100 Application at 37-38; Gilbert and Harris at ¶ 27.

101 Gilbert and Harris at ¶ 27.

102 Id.

103 Id. at ¶ 34.

104 Id. at ¶ 39.

of the potential for many of these efficiencies. Indeed, considered inquiry suggests that the efficiencies may be realized without a merger or, alternatively, would not, in fact, be achieved by the proposed transaction. These are each discussed briefly below, and more fully examined in the paper by Drs. Besen, Srinagesh and Woodbury.

Innovation incentives and the speedy introduction of new services and technologies. The level of a firm's innovation incentives cannot be predicted through myopic consideration of the firm's mere ability to appropriate returns from the innovation.[105] Rather, competing forces complicate the analysis. The Besen, Srinagesh and Woodbury analysis explains that "[a]lthough the monopolist can appropriate more of the return from innovation, its incentives to innovate may be diminished by the lack of rivalry."[106] Hence, the merged firm's ability to forestall competitive entry comprises a critical element for predicting its innovation incentives.

The incumbent firm retains the incentive to protect the profit flow derived from a pre-innovation market. The absence of effective rivalry from new entrants diminishes the incumbent's innovation incentives and encourages the maintenance of the

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105 Nor is firm size an accurate predictor of innovation incentives. As the Besen, Srinagesh and Woodbury analysis explains, "[i]n some cases, there is a positive relationship between firm size and innovation; in others, there is no relationship; and in yet others, the relationship varies non-monotonically with firm size." Besen, Srinagesh and Woodbury at 29.

106 Id. at 25-26.

current method of providing telecommunications service. As described above and as analyzed more fully by Drs. Katz and Salop, the proposed merger would reduce the competitive effectiveness of local exchange and interexchange rivals of the merged entity. The merger could thus actually reduce innovation incentives; in any event, neither economic theory nor empirical evidence supports the Application's claim that the merger would increase them.

The diffusion of best practices and benchmarking difficulties. Taken at face value, the contention that Ameritech and SBC had no intention of competing with one another suggests that the diffusion of best practices would occur without a merger (i.e., contractually). Indeed, the diffusion of best practices and the purportedly concomitant lowered costs and facilitation of new service deployment, appear more likely absent a merger. As the Besen, Srinagesh and Woodbury analysis demonstrates, the merger may actually diminish the firms' incentives to adopt one another's efficiency-generating practices due to benchmarking considerations.[107]

The firms' operating companies confront different regulatory and economic environments. Different regulators measure the practices of one operating company against the practices of

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107 Id. at 41 ("[T]he merger will not facilitate the diffusion of cost-saving best practices, and . . . some cost-increasing best practices that would be adopted pre-merger will not be adopted post-merger.").

operating companies in other regulatory jurisdictions.[108] Aware of this tendency, a firm considers the effect of one operating company's profit-enhancing practices on related operating companies (i.e., how the related operating companies would perform under the same practices if required by regulators to adopt them). Hence, collateral considerations dampen an operating company's willingness to adopt potentially efficient operating practices.

Where SBC and Ameritech are separate entities, they need not consider the effects of their respective operating company practices on the other's operating companies. However, in a post-merger environment, the potential effects of any efficiency-producing practice will be considered in relation to a greater geographic area (i.e., the combined SBC/Ameritech territories). Consequently, the merger could in fact dampen the diffusion of best practices between Ameritech and SBC. By contrast, the pre-merger companies presently retain greater incentives to adopt such practices.

Economies of scope and scale beyond those presently available are unlikely to be realized. Except in a few instances, Ameritech and SBC serve disjointed territories and do not own duplicative and redundant facilities. These facts alone largely refute Gilbert and Harris' claim that the merger will permit realization of scope and scale economies. Still, Gilbert

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108 In their attached affidavit, Professor Farrell and Dr. Mitchell analyze in greater depth the benchmarking implications of the proposed merger.

and Harris point to consolidation of outsourcing and purchasing activities of the two companies as a gain to be achieved through merger.[109] Deeper inquiry, though, reveals that such consolidation may actually reduce net public benefits by raising outsourcing costs for independent firms and resulting in inefficient behavior by the merged entity.

The Besen, Srinagesh and Woodbury analysis offers tangible examples.[110] The retreat of Ameritech from outsourcing switch maintenance, billing, OSS, and other data center activities will reduce scale economies of the third party providing these services, leading to increased costs for remaining users of this third party's services. Moreover, pre-merger Ameritech has not sought the services of SBC to fill its outsourcing needs, perhaps because SBC has not presented a cost-effective option. It can be rationally presumed that SBC offered Ameritech a suboptimal alternative to its present outsourcing contractors. Consequently, any post-merger transfer to SBC of Ameritech's outsourcing functions may represent an overall efficiency reduction. Finally, it bears mentioning that any efficiencies manifest by such consolidation are achievable contractually in the absence of a merger.

Claims of merger-produced revenue synergies are not supported logically or empirically. The Gilbert and Harris affidavit projects approximately $778 million in increased

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109 Gilbert and Harris at ¶¶ 43-44, 54.

110 Besen, Srinagesh and Woodbury at 39-40.

revenue synergies as a result of the merger.[111] However, even assuming that such growth projections are reasonable, the application fails to present sufficient empirical evidence to conclude that post-merger revenue growth is attributable to the merger, rather than to general market trends existing outside the context of the merger such as independent growth in demand for the identified services. Without sufficient empirical support, there is no reason to assume that post-merger revenue growth is indicative of merger-related public benefits.

Indeed, the contrary conclusion is equally plausible. The merger will provide the merged entity an increased ability to engage in anticompetitive practices. As Besen, Srinagesh and Woodbury submit, the claimed revenue synergies may result from diversion of customers to SBC from competitors as a result of the merged company's anticompetitive behavior -- an effect clearly at odds with the public interest.[112]

Taken together, the woefully inadequate empirical support for the asserted merger efficiencies and the logically predictable net public welfare and efficiency reduction strongly counsel against approval of the application on these bases. In this regard, it is worth emphasizing that the concerns expressed by Gilbert and Harris concerning the risk of stranded assets in the absence of a merger are also erroneous. Raised in a poorly

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111 Gilbert and Harris at ¶ 39.

112 Besen, Srinagesh and Woodbury at 38 (noting that "revenue synergies might well be an index of the public harm that would result from the merger").

disguised effort to frighten regulators into approving the merger lest doomsday result, the very premise of stranded assets here fails to consider the larger risk to ratepayers if the merger is approved. The large business segment that the National-Local Strategy is purportedly designed to target, according to SBC, is vigorously competitive. Kahan at ¶ 64. As Besen, Srinagesh and Woodbury explain, this market is unlikely to generate large margins and reduce the identified ratepayer risk. Besen, Srinagesh and Woodbury at 26-27. Indeed, SBC appears prepared to pass all of the risks of its National-Local Strategy -- a project involving $23.5 billion in out-of-region expenses -- to its in-region customers and not its shareholders. Kahan at ¶ 80 (asserting need to maintain dividend payments). Hence, an approved merger involves greater risks for residential and small-business ratepayers than does a rejection of the application.

VIII. Post-merger Conditions Have Not Been Effective And Thus Cannot Be Relied Upon To Diminish The Adverse Competitive Effects.

As demonstrated, the anticompetitive consequences of allowing the merger are unambiguous. The Commission should not content itself with allowing the merger and relying on conduct regulation after the fact. Professors Krattenmaker and Salop, two of the originators and proponents of the "raising rivals' costs" non-price predation theory, have noted its applicability to merger policy. "Analyzing Anticompetitive Exclusion," 56 Antitrust L. J. 71, 81-82 (1987).[113]

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[113] Similarly, in an extensive note on the Cargill case, one commentator has suggested that a merger enabling a firm to

Further, the Commission's statutory mandate extends well beyond merely correcting bad conduct to assuring efficient industry structures which themselves will aid to minimize such misconduct. See GTE of the Southwest v. FCC, 449 F.2d 846, 853-856 (5th Cir. 1971); GTE Service Corp. v. FCC, 474 F.2d 724, 730 (2nd Cir. 1973).

Conditions have not been sufficient even in the context of more benign mergers. As discussed, *Bell Atlantic-NYNEX* set forth multiple conditions subsequent to the merger of those local monopolies. The conditions became effective upon release of *Bell Atlantic-NYNEX* or shortly thereafter, with all obligations scheduled to sunset in 48 months. These conditions relate to performance standards and associated remedies, performance monitoring reports, Operations Support Systems, and pricing. Within the first few months, however, it became apparent that Bell Atlantic would marshall its efforts in order to evade those requirements or to stall required negotiations with competitors. Accordingly, competitors were forced to file section 208 complaints seeking relief from the Commission.

In late 1997, AT&T and MCI each filed a complaint alleging that Bell Atlantic refused to price in accordance with *Bell Atlantic-NYNEX* conditions.[114] AT&T complained that "[i]n none of

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predate by raising the price of a rivals' input could satisfy the Cargill standard. Cotter, "Note: Cargill, Inc. v. Monfort of Colorado, Inc., The Supreme Court Restricts Private Antitrust Challenges to Horizontal Mergers," 1987 Wisc. L. Rev. 503, 530-31 (1987).

114 See *MCI Complaint*, MCI Telecommunications Corp. and MCImetro Access Transmissions Services, Inc., File No. E-98-12 (FCC,

[its seven pre-merger][115] jurisdictions has Bell Atlantic offered competing LECs access to network elements and interconnection at truly TELRIC-based rates."[116] Rather, Bell Atlantic interpreted the Commission's TELRIC standard to permit Bell Atlantic to recover its "actual" costs -- including embedded costs. Furthermore, AT&T argued that "Bell Atlantic's obligations regarding this forward-looking cost standard applied to existing offerings, not just those that post-dated the Commission's Merger Order."[117] The 1997 MCI Complaint echoed the problems identified in AT&T's complaint, using Bell Atlantic's proposals before the Pennsylvania PUC as a proxy for Bell Atlantic's activities before each of its respective state commissions.

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filed Dec. 19, 1997) ("1997 MCI Complaint"); *AT&T Complaint*, AT&T Corp. v. Bell Atlantic Corp., File No. E-98-05 (FCC, filed Nov. 5, 1997) ("AT&T Complaint"). These complaints, by their own terms, only apply to the former Bell Atlantic states. See AT&T Complaint at n.1; 1997 MCI Complaint at n.1.

115 Delaware, District of Columbia, Maryland, New Jersey, Pennsylvania, Virginia and West Virginia.

116 AT&T Complaint at ¶ 21.

117 AT&T Complaint at 4 (citing *Bell Atlantic-NYNEX*, at ¶ 185 -- "Bell Atlantic-NYNEX must, irrespective of whether either Bell Atlantic or NYNEX has a prior agreement with a competing carrier, offer all of the terms contained in the conditions to all competing carriers upon request.") For its part, Bell Atlantic has ignored the thrust of *Bell Atlantic-NYNEX*, which contemplates that all competitors will benefit from prices established at costs (see *Bell Atlantic-NYNEX*, at ¶ 200) including the condition #9 attached thereto, and has argued that only post-merger prices need be based upon forward-looking costs, and that pre-merger prices are not affected by the terms of *Bell Atlantic-NYNEX*. See *Bell Atlantic Answer*, AT&T Corp. v. Bell Atlantic Corp., File No. E-98-05 (FCC, filed Dec. 15, 1997).

MCI filed a subsequent complaint in March 1998,[118] which alleged that Bell Atlantic again violated the merger conditions by "refusing to negotiate in good faith to develop adequate performance standards, remedies, and associated reporting."[119] The 1998 MCI Complaint chronicled MCI's submission to Bell Atlantic of a comprehensive proposal addressing performance reporting, standards, and remedies, followed by Bell Atlantic's tactics to slow and extend the process.

In addition to these complaints to the Commission, Sprint and MCI have shown that Bell Atlantic has failed to satisfy the conditions to *Bell Atlantic-NYNEX* in two other respects. In a filing with the NYPSC, Sprint demonstrated that "notwithstanding Sprint's [July 1, 1998] request to BANY for carrier-to-carrier performance metrics, [as of August 17, 1998] Sprint has received no such metrics from Bell Atlantic."[120] In addition, MCI noted in a filing with the NYPSC that

> BA-South's current [OSS is] different from the systems available in BA-North. MCI has requested that BA-NY identify which systems will be in place in compliance with [*Bell Atlantic-NYNEX*], but to date MCI has not received an answer from BA-NY.[121]

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118 *MCI Complaint*, MCI Telecommunications Corp. and MCImetro Access Transmissions Services, Inc. v. Bell Atlantic Corp., File No. E-98-32 (FCC, filed Mar. 17, 1998) ("1998 MCI Complaint").

119 1998 MCI Complaint at ¶ 8.

120 See Sprint Comments filed re: NYPSC Case 97-C-0271 at 3 (Aug. 17, 1998).

121 See MCI Comments filed re: NYPSC Case 97-C-0271 at 12 (Aug. 18, 1998).

While these issues are pending at the FCC and the New York Public Service Commission, it is worth emphasizing the most recent rulings from New York on Bell Atlantic's general compliance. Following hearings and her review of thousands of pages of evidence, a NYPSC Administrative Law Judge found that Bell Atlantic-New York had not met its burden of proof with respect to its Section 271 Prefiling Statement, and noted the difficulty in obtaining services and elements in a timely manner and clear lack of OSS parity.[122] The same judge also recently found that "as a matter of fact on this record" that none of BA-NY's proposed UNE combination methods constitute a nondiscriminatory form of obtaining and combining unbundled elements.[123] The FCC's experience overseeing the *Bell Atlantic-NYNEX* conditions exposes the limitations of an overworked agency to compel compliance with complex conditions subsequent to a merger of two local monopolies. While the foregoing complaints have been pending before the Commission, the 48-month sunset provision continues to toll. In the interim, Bell Atlantic has little incentive to do anything but drag its feet and contest the best efforts of AT&T, MCI, and other CLECs to enforce the conditions.

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122 Petition of New York Telephone Company for Approval of its Statement of Generally Available Terms and Conditions and Draft Filing of Petition for InterLATA Entry, NYPSC Case 97-C-0271, *Ruling Concerning the Status of the Record* at 1 (July 8, 1997).

123 Proceeding on Motion of the Commission to Examine Methods by Which Competitive Local Exchange Carriers Can Obtain and Combine Unbundled Network Elements, NYPSC Case 98-C-0690, *Proposed Findings of Administrative Law Judge Eleanor Stein* at 10 (Aug. 4, 1998).

In the 271 context, Congress saw the necessity of adopting a carrot or incentive approach to encourage the entrenched local monopolies to open their markets. Even this approach has been strained, as we have learned that the interLATA carrot is not nearly as satisfying a meal as the de facto local monopoly. There is no basis to believe reiteration of these RBOCs' legal obligations as merger conditions would help make their fulfillment any more real.

CONCLUSION

The proposed merger is anticompetitive and contrary to the public interest. Sprint respectfully urges the Commission to deny the Application.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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